Part III
Antitrust Law and Forced Access

Although proponents of Forced Access frequently use the language of antitrust, the principles of American antitrust law are contrary to Forced Access. To begin with, one must remember that antitrust laws are meant for the "protection of competition, not competitors."[95] Supreme Court Justice Stephen Breyer explained:

> [A] practice is not "anticompetitive" simply because it harms competitors. After all, almost all business activity, desirable and undesirable alike, seeks to advance a firm's fortunes at the expense of its competitors. Rather, a practice is "anticompetitive" only if it harms the competitive process. It harms that process when it obstructs the achievement of competition's basic goals—lower prices, better products and more efficient production methods.[96]

Cable broadband is promoting, not harming, the basic goals of competition identified by Breyer. It has already dramatically lowered prices for broadband, leading to cuts of 50 percent or more in DSL prices. It is offering a product far superior to the narrowband access most consumers must use today. And it is making production more efficient because it moves the "last mile" of Internet data off old-fashioned voice telephone lines and voice telephone switches, and onto a system optimized for pure data transmission.

What Is the Relevant Market?

[95] *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).

[96] *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 25-26 (1st Cir. 1990). (At the time of this case, Stephen Breyer was a judge on the First Circuit Court of Appeals.)

Legislation such as H.R. 1685 and 1686 (the national Forced Access bills) would automatically define as an antitrust violation a cable television company's decision not to accept Forced Access. A preliminary inquiry in any antitrust case is how much power the alleged violator has in the "relevant market." Sears may have a monopoly on "Sears Craftsman Tools," but the relevant market is not "Sears Craftsman Tools"; the relevant market is "home workshop tools."

In the case of cable Internet access, the relevant market is "Internet access." In this relevant market, no cable television company could possibly have "market power." Even by 2003, "seventy five percent of the market will be narrowband because people want it as easy and inexpensive as possible," according to AOL President Steve Case.[97] Cable Internet access will have only a fraction of the remaining 25 percent of Internet access.

Arguably, the relevant market could be defined as "broadband Internet access," rather than "Internet access" in general. Even there, cable television providers will not have market power. They face strong competition from DSL and wireless right now, and will continue to do so for years to come.

But H.R. 1685 and 1686 get around this problem by constructing an artificial definition of the "relevant market." According to these bills, the "relevant market" consists only of cable broadband access. By this odd definition, the cable Internet companies are defined into being a monopoly, since most localities have only one cable television company. It is as if the "relevant

[97] Steve Case, CNBC, September 28, 1998.

market" for Mercedes-Benz automobiles were defined not as "automobiles" or as "luxury automobiles," but as "Mercedes-Benz automobiles."

Right now, competitors of the cable companies have every legal right to bring antitrust suits against the cable companies. But these potential plaintiffs face the problem of having to prove (as a starting point) that the cable companies have "market power" in the "relevant market."

Under traditional antitrust caselaw, these plaintiffs could not survive a motion for summary judgment, since the cable companies do not have market power in any "relevant market" defined by ordinary antitrust law. That is why H.R. 1685 and 1686 must create a statutory definition of the "relevant market"—in order to prevent courts from making normal antitrust inquiries into what the relevant market really is.[98]

[98] Interestingly, H.R. 1685 and 1686 would appear to outlaw the types of arrangements AOL has been making with ILECs. The bill makes it a presumptive antitrust violation for a broadband provider to offer different terms to different ISPs. AOL's arrangements for DSL with SBC, Bell Atlantic, and Ameritech all give AOL much better terms than are given to other ISPs.

Is Cable Broadband an "Essential Facility"?

Another step in the antitrust chain of reasoning is the "essential facilities" doctrine.[99] This doctrine requires that the holder of an "essential facility" make the facility open to other companies on a commercially reasonable basis. For example, if the only way in or out of a particular valley is via a single railroad, then the railroad will have to transport agricultural products grown by farmers in the valley—even if the railroad would prefer to ship products only from farms the railroad owns.

Although, as Supreme Court Justice Breyer observes, essential facilities is "a doctrine that this Court has never adopted,"[100] the doctrine does play an important role in current antitrust law. In the Portland case, the federal district court held that AT&T/TCI's cable broadband was in fact an "essential facility."

But this holding is plainly erroneous. First, there are currently many ways (in Portland and elsewhere) to obtain Internet access—first and foremost through the many narrowband ISPs. Even if one makes the leap that broadband Internet access is "essential" (rather than simply desirable or advantageous), there are still other ways, as I have described earlier, to obtain broadband Internet access. In Portland, for example, one may obtain broadband Internet access via DSL from U.S. West, via DSL from Covad (a CLEC), and via satellite from DirecTV.

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[99] An essential facility may not exclude competitors unless there is a "legitimate business reason for the refusal." *City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373, 1370 (9th Cir. 1992).

[100] *AT&T v. Iowa Utilities Board*, supra note 15 (Thomas, C., concurring and dissenting on other grounds).

AT&T/TCI's broadband services are, then, hardly "essential" when there are at present three competing providers for the same service. That AT&T/TCI's service may in some respects be superior (arguably) or less expensive does not transform AT&T/TCI's service into an "essential facility." The "essential facility" label should not be a punishment inflicted for providing a better product.

Does Bundling Violate Antitrust Laws?

Vertical integration allows the integrator to reduce transactions costs, reduce risk, and capture certain economies of scale.[101] For example, a vertically integrated oil company that has a secure supply of oil for its retail outlets can deliver its product at a lower price when supply interruptions might be forcing its competitors to charge more. The vertically integrated company does this not to be nice to its consumers, but in order to sell more of its product.

Vertical integration works in the same way in the market for Internet access, and it already is reducing Internet prices. For example, while AOL charges consumers $21.95 per month for Internet access, MCI sells Internet access for just $14.95 to consumers who also use MCI's long-distance telephone service.[102]

To force a vertically integrated company to make its facilities available to rivals at the

[101] R.H. Coase, "The Theory of the Firm," *Economica*, November 1937, reprinted in Coase, *The Firm, The Market and the Law* (Chicago: University of Chicago Press, 1988).

[102] William F. Shughart II, *The Government's War on Mergers: The Fatal Conceit of Antitrust Policy* (Cato Institute, Policy Analysis #323, October 22, 1998), page 16.

same price the company uses internally would destroy the advantages and economies created by vertical integration. For example, disagreements within a company over how much to charge for a certain service or use of a particular asset can be resolved by unit managers, in the CEO's office, or finally in the board room. But if other companies have an entitlement to use those services or assets, disputes are far more likely to be settled in court, in front of regulators, or by lobbying Congress. These dispute settlement methods are far more costly to the parties than those that are internal to the company. Consequently, the price mandated under Forced Access would be too low to allow the company to earn its expected rate of return.[103]

Why Forced Access and Antitrust Don't Mix

Although the Portland district court used antitrust law as a rationale for the Forced Access mandate, Forced Access is a particularly bad solution even when there are genuine antitrust problems. Federal Trade Commission Chairman Robert Pitofsky explains why:

> Antitrust rarely mandates access for several reasons:
>
> (1) If access is too easy, companies will be inclined to lay back and take no risks on the assumption that they can free ride on the earlier investment and energy of their competitors;
>
> (2) Permitting easy access for competitors can dampen the incentives for firms to undertake risky and costly investments in the first place, unless there are countervailing first-mover advantages; and

[103] Ibid., pages 15-16.

(3) It achieves little to mandate access unless there is also provision to insure that price and other conditions of sale are "reasonable;" otherwise the monopolist can grant access but introduce terms that are so onerous that as a practical matter it is unavailable. But regulating price and other terms of sale on a continuing basis is exactly the thing that antitrust (as opposed to the regulatory agency with ongoing oversight of firms in the industry) is ill-equipped to manage.[104]

In sum, antitrust law provides no rationale for the imposition of Forced Access on the cable television companies. Cable broadband is not a monopoly or an essential facility. Vertical integration is pro-consumer. Forced Access undermines competition and requires continued, inappropriate, judicial micromanagement of a company's affairs. For this last reason, even if Forced Access were thought to be a wise policy, Forced Access should be imposed via regulation by the Federal Communications Commission, rather than though antitrust lawsuits (as H.R. 1685 and H.R. 1686 would do).

[104] Robert Pitofsky, chairman, FTC, *Competition Policy in Communications Industries: New Antitrust Approaches* (Glasser LegalWorks Seminar on Competitive Policy in Communications Industries, March 10, 1997), http://www.ftc.gov/speeches/pitofsky/newcomm.html (paragraph formatting changed from the original).

Part IV
Impact of Forced Access on Infrastructure Development

Everyone agrees that expanding the broadband communications infrastructure is desirable. The best way to *discourage* investment in, and creation of, any type of property is to destroy the property rights of the investors and creators of that property. A good example of this phenomenon is rent control.

During World War II, New York City began an experiment with a version of Forced Access known as "rent control" and "rent stabilization." The government decided what prices could be charged for apartment rentals and forbade apartment owners to lease their property to customers who would pay free-market rates.

The effect on New York City's housing stock was catastrophic. Apartment building owners sharply curtailed investments in low-priced apartments, property upgrades, and maintenance, since they would not be allowed to recover those costs through market-determined rents. People who would have moved into new construction or single-family homes chose instead to stay in their current apartments to enjoy below-market rates, further decreasing the supply of affordable housing. As low-priced apartments crumbled or were withdrawn from the market, New York City's housing became less and less affordable for low- and middle-income renters.[105]

[105]Thomas Sowell, *Knowledge and Decisions* (New York, NY: Basic Books, 1980), pages 176-182.

Forced Access for cable broadband is a high-tech version of rent control—a "solution" that will cause tremendous problems, and discourage the creation and improvement of infrastructure.

Lowering the Rate of Return on Technological Investment

Without the slightest bit of thought or creativity, any business can invest money in Treasury Certificates of Deposit or in AAA-rated corporate bonds. For a rational company to choose to invest its money in infrastructure improvements, the company must believe the investment will yield a higher return than will a simple investment in government or corporate bonds. Moreover, investing in government or high-rated corporate bonds runs only a tiny risk that the investment will not be repaid. But the investment in infrastructure might fail entirely, and pay back nothing (or only a little). Thus, the potential return from the infrastructure investment must be high enough to compensate for risk of failure.

What sensible company would invest millions or billions in developing new broadband technology if it knew a politically connected competitor might use federal or local political power to help itself to the company's physical assets? What bank would build a network of Automated Teller Machines if the bank's competitors (which invested nothing in the physical capital) could have guaranteed use of the ATMs—at a price set by political officials (rather than at a price mutually agreed by the banks)?

The development of ATMs provides an important lesson for the development of broadband. Today, ATMs are highly interoperable; almost any ATM will allow withdrawals from almost any bank. This interoperability was achieved naturally, because of free-market economic incentives.

In the early days of ATMs, the machines were *not* interoperable. An ATM card issued by a particular bank would work only at an ATM owned by that bank. Because the government did not mandate Forced Access, banks (or groups of banks) that had not yet built ATMs had a strong incentive to build their own. Thus, ATMs proliferated.

Eventually, different banks found it economically advantageous to make interoperability agreements with other banks. Later, these ATM banking groups found it advantageous to make interoperability agreements with other ATM groups. These agreements made sense precisely because there was so much ATM infrastructure; each bank (or group of banks) had a large installed infrastructure of ATMs. Because the government did not interfere with the property rights of ATM owners, competing banks had strong incentives to build many ATMs. Once ATMs were ubiquitous, competing banks had strong incentives to let each other's customers use their networks.

Now imagine the Forced Access model had been imposed on banks. As ATM leaders (such as Citibank) began building their proprietary ATM networks, competing banks (which had not built ATMs) would demand that Citibank ATMs process transactions from these other banks.

And the government would force Citibank to let other banks use its ATMs. Thus, Citibank's competitive advantage in building ATMs would be curtailed. And the smaller banks would have no competitive incentive to build their own ATM networks.

Similarly, in the early days of e-mail, systems were not interoperable. A CompuServe customer could easily send e-mail to another CompuServe customer, but sending e-mail to someone on another system (e.g., a university network) was difficult or impossible. This gave larger providers with many customers (e.g., CompuServe, AOL, or MCI) a competitive advantage; a new customer who signed up with a big company would be able to send mail to many people, but a new customer of a small company could not send e-mail so broadly.

Today, e-mail is fully interconnected. Any e-mail user can e-mail any other e-email user. This was accomplished with absolutely no government intervention. Can we be sure we would have arrived at this happy state so quickly if the government had forced access—for example, if CompuServe (now owned by AOL) had been required to carry traffic from smaller companies, and to give the traffic the same priority that CompuServe's own e-mail received? Would the companies that now provide the backbone for e-mail traffic have invested so heavily in creating and upgrading that backbone if smaller companies had been able to help themselves to the fruits of the larger company's labor?

Because cable television companies have (so far) not had to worry about the government forcing them to share their infrastructure with competitors, cable's infrastructure investment has

been immense. Between 1984 and 1992, the cable television industry spent $15 billion wiring the United States—the largest private construction project since World War II.

To digitize that infrastructure, AT&T is spending $1.8 billion to upgrade the TCI cable lines to bring broadband Internet to 10.8 million homes, and $600 million to upgrade the lines serving 4.2 million MediaOne homes.[106] Comcast (another cable company) is spending $1.2 billion for its broadband upgrade.[107] Time Warner is spending $4 billion.[108] Those investments would not have been made if these companies could not legally exclude other companies from free-riding off their investments. Should Forced Access become public policy nationwide, it is highly unlikely this rate of investment would continue.

Risk, Reward, and Free Riders

In his classic article, "The Tragedy of the Commons," Garrett Hardin described how the absence of well-defined and properly enforced property rights can lead to less wealth for everyone. Hardin described a hypothetical village whose residents could graze their sheep for free on the town commons. The arrangement meant everyone had an incentive to graze as many sheep as possible, and no one had an incentive to cultivate the grass. The result was overgrazing, damage to the grass, and many starving sheep. A better system would have been to sell or assign

[106] Scott Woolley, "A Two-front War," *Forbes*, May 31, 1999, page 55.

[107] FCC Report, supra note 5, page 18, citing Comcast data.

[108] Timothy Boggs, senior vice president, Time Warner, Inc. H.R. 1685 hearings. One cause for the large cost is that cable companies must, according to their contracts with cities, upgrade an entire service area, even if demand is likely to be low in some neighborhoods. Cable companies also must wire public schools for free.

tradeable grazing rights to each resident, and then let the resulting market allocate access to the commons as well as raise the funds necessary to cultivate the grass.[109]

More recently, economists Gregory Sidak and Daniel Spulber studied the telecommunications industry and found the same problem Hardin had described.[110] If Forced Access turns private broadband resources into communal property, then no one will have an incentive to produce more broadband resources, and everyone will have an incentive to consume the most broadband possible.

In an efficient economic system, risk and reward go together. Whoever takes the risk of failure should reap the reward of success. If a company must bear all the risks, but must share much of the rewards with its competitors, the company will stop taking risks.[111]

As cable companies upgrade their cable lines to allow digital broadband Internet service, they pay all of the costs, and they face all of the risks. If consumers are less interested in broadband than the cable companies hope they are, or if other technologies such as DSL or wireless take away too many of the potential cable broadband customers, or if a recession curtails consumer demand for luxuries like broadband, or if the cable broadband technology does not work well enough, the cable television companies will absorb every bit of the losses.

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[109]Garret Hardin, "The Tragedy of the Commons," in Hardin, editor, *Managing the Commons* (New York, NY: W.H. Freeman, 1977).

[110] J. Gregory Sidak and Daniel F. Spulber, *Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States* (Cambridge University Press, 1998).

[111] Frank Easterbrook, "The Court and the Economic System," 98 *Harvard Law Review* 4 (1984).

Companies clamoring for Forced Access are demanding the right to use another company's property. But they are unwilling to assume any of the risks from the creation and improvement of that property. If broadband cable turns into an economic disaster, the companies that built or upgraded the cable lines will suffer *all* of the loss. The members of the OPENNET Coalition will certainly not chip in to help AT&T/TCI or Time Warner pay off their wasted investments.

Why should any reasonable company invest hundreds of millions or billions of dollars to improve or build a facility, when there is a significant chance that regulators will give some of the facility to free-rider competitors? Why not just invest the money in certificates of deposit—whose rewards will belong only to the company and the tax collector?

Do the Foxes Have the Hens' Best Interests at Heart?

OPENNET leader Charles Brewer (head of the narrowband ISP Mindspring) claims cable television companies' current policy "actually slows investment in broad-band services by blocking investment by Internet service providers that are willing and able to pay to offer high-speed services to the millions of subscribers they have today."[112] But OPENNET Coalition members are not clamoring to *invest* in the cable companies' equipment upgrades. If they wanted to invest in the upgrades, they could work out joint ventures with, or simply buy stock in, cable companies.

[112] Charles Brewer, "Why Hurry Up and Wait?" *USA Today*, April 5, 1999.

If members of the OPENNET Coalition are so sure cable companies can make more money in the long run by letting free riders use the cable companies' property, then they should buy a cable company, invest hundreds of millions in improving the cable lines, and then give away "open access" to those cable lines. Many members of the OPENNET Coalition have large enough market capitalizations to buy several cable television companies. Indeed, OPENNET Coalition member U.S. West used to own the cable company MediaOne, which AT&T purchased. No one prevented U.S. West from retaining ownership of MediaOne, upgrading its lines, and then letting other firms have open access to those lines.

Resale Competition versus Real Competition

Forced Access encourages potential new competitors to operate forever on a "resale" model[113]: They will buy product (e.g., bandwidth) from whoever created the product and is being forced to sell it through Forced Access. The "competitor" then repackages the product and re-sells it to the consumer. This static model might make sense if it were impossible for new products to be created, but this is clearly not the case with the rapidly changing and highly innovative Internet access market. Resale competition makes it harmful for the property owner to spend money to upgrade the property, since both the property owner and its "competitors" benefit from the upgrade, but only the property owner incurs the cost.

Contrast resale competition with facilities-based competition, whereby each competitor

[113] 47 U.S.C. 251(c)(defining resale competition as one competitor leasing a part of a network, and reselling the network services under its own name).

builds its own facilities and competes by offering facilities superior to (or more cost-effective than) the facilities of other competitors. Unlike resale competition, facilities-based competition encourages the construction and improvement of facilities. The benefits for broadband, under the current system of facilities-based competition, are clear: Improvements in cable facilities have led directly to better (and cheaper) broadband facilities being constructed or improved by telephone and satellite companies.

The Telecommunications Act of 1996 has not produced the hoped-for results in competition. But where a massive, complex federal statute has failed, innovative, aggressive companies are succeeding. "The growth of the broadband data market is a bigger factor driving the industry than a slow-paced march toward deregulation," explains Bob Fax, the chief telecommunications analyst for Mercer Management Consulting.[114]

[114] Reinhardt Krause, "Web Weaving Its Way Through Telecom Industry," *Investor's Business Daily*, June 9, 1999, page A4.

Part V
Summary and Conclusion

Forced Access is a species of theft in which some businesses hope to use government coercion to plunder property being built and improved by their competitors. There is something profoundly wrong with a lobbying campaign built on so unfair a premise. The victims of the Forced Access campaign are innovative cable television companies, who want to offer high-speed broadband Internet access through cable television lines, and Internet consumers.

Forced Access isn't necessary. With the explosive growth of residential broadband, new levels of economic growth and consumer satisfaction are coming. Competition is intense within the cable television industry, and among the different industries using differing technologies to provide people with high-speed access to the Internet. In this instance, markets are plainly working, attracting new investors and new organizational forms, driving down prices, and holding producers accountable to their consumers.

Forced Access would be counterproductive. It would cripple the growth of broadband Internet services for consumers and small businesses. Because Forced Access has not yet been forced on the cable television companies, broadband competition among many different providers is thriving. Forced Access would remove the most important competitive pressure on all other broadband providers. In the last five years, a free and open Internet, based on voluntary exchange rather than bureaucratic regulation, has contributed to unprecedented productivity growth and prosperity for America.

Do we want the Internet to be run like a public utility, for which a large government bureaucracy controls prices and forces the utility to make its facilities available to everyone? Do we want the Internet to be a world of ratepayers, or a world of consumers? Is competition to be a zero-sum game, in which the government should allocate resources among competitors? Or is competition a win-win game that enriches society by encouraging innovation, cooperation, and risk-taking?

Do we want broadband to be run the way the personal computer business has been, with almost no regulation, continually declining costs, and continually increasing quality? Or do we want broadband to be run like defense procurement, where decision-making is ponderously slow and heavily influenced by politics?

Ultimately, the Forced Access proposal requires America to choose between a thriving free-market Internet and one based on regulation and politics. Keeping the Internet free and growing requires that judges and elected officials not commit the fatal conceit of believing they can substitute their own judgment for the wisdom of millions of Internet users, entrepreneurs, and investors. That means relying on markets, not regulations.

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